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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 947

FRANK WHITE ET UX, MRS. FRANK WHITE,
Petitioners,

vs.

W. A. THOMAS, COLLECTOR OF INTERNAL REVENUE.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

WM. A. BLAKLEY,
Counsel for Petitioners.

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SUPREME COURT OF THE UNITED STATES

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

To the Honorable the Supreme Court of the United States:

Frank White, and wife, Mrs. Frank White, pray that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fifth Circuit entered in the above case on the 5th day of December (R. 141), 1940, affirming the judgment of the District Court of the United States for the Northern District of Texas, Dallas Division, and in this connection respectfully show:

I.

Summary Statement of the Matter Involved.

A. History of the Case.

This is an action at law brought in the District Court of the United States for the Northern District of Texas, Dallas Division, by Frank White and wife, Mrs. Frank White, petitioners, as plaintiffs, against W. A. Thomas, Collector of Internal Revenue for the Second Collection District of Texas, respondent herein, as defendant, for the refund of income taxes for the year 1932 alleged to have been unlawfully collected by respondent from petitioners.

Two separate suits were originally filed in the trial court, one by Frank White as plaintiff, and the other by Mrs. Frank White as plaintiff, against W. A. Thomas, defendant. The two suits were consolidated for trial, the order for consolidation appearing in the judgment of the trial court (R. 131).

Trial was had before Hon. William H. Atwell, District Judge, sitting without a jury, and at the conclusion thereof, on March 18, 1940, judgment was rendered in favor of defendant in the trial court, that plaintiffs take nothing, and that defendant recover his costs (R. 131). Findings of fact and conclusions of law were included by the trial judge in his opinion (R. 129).

Plaintiffs duly and timely perfected their appeal from said judgment to the Honorable United States Circuit Court of Appeals for the Fifth Circuit. All of the proceedings and evidence in the trial court were designated as the Record on Appeal (R. 135).

The appeal was argued before Circuit Judges Sibley, Holmes, and McCord, and on December 5, 1940, the Circuit Court of Appeals rendered its judgment affirming the judg-

ment of the District Court, being found in the Record herein at page 141, and officially reported at 116 F. (2d) 147.

Appellants Frank White and Mrs. Frank White duly and timely filed motion for rehearing in the Circuit Court of Appeals, which motion was by that Court denied, without opinion, on January 14, 1941 (R. 149).

B. Nature of the Case.

The statement of the facts as contained in the opinion of the Court below (found herein at R. 138), is here set out as being a concise statement of the facts. It reads as follows:

Frank White and his wife sued the Collector of Internal Revenue for income taxes for the year 1932 which were exacted on account of $125,000 paid that year to Frank White by the executors of the will of Mrs. Margaret A. Shannon and by the trustees of a charitable trust to which she had devised the bulk of her large estate. The payment was in compromise and settlement of a suit brought by White against them to recover a ranch consisting of about 124,000 acres and valued at about $700,000, and a counter suit by them against White to remove his claims to any of the estate as a cloud upon their title. The claim of White was that Mrs. Shannon, and her husband before he died and devised his lands to her, had given the ranch to him. The evidence shows that he had long lived with the Shannons and was beloved of them though no kin. He testified of things they said to him and others which indicated that the ranch should be his; but there was no present gift, he had nothing in writing, and no possession of it. The ranch was in fact expressly mentioned in Mrs. Shannon's will as devised to the charitable trust. The compromise agreement was that White be paid $125,000 in addition to all properties given him by the will, and that White "releases all claims to any properties passing under the last will and last testa-

ment of said Margaret A. Shannon deceased except such as are specifically bequeathed to him to which reference has heretofore been made, and agrees upon request of the parties of the first part either as trustees or executors, to make, execute and deliver proper written conveyances, acquittances and releases from any and all claims heretofore made or to be made by him * * *." Judgments were accordingly taken against him for all the properties except those given him by the will.

II.

Jurisdiction.

The jurisdiction of this Court is invoked under section 240(a) of the Judicial Code as amended by the Act of February 13, 1925, c. 229, 43 Stat. 938. The judgment of the Circuit Court of Appeals was entered December 5, 1940 (R. 141). Petition for rehearing was denied January 14, 1941 (R. 149). This petition for writ of certiorari was filed April 12, 1941.

III.

Questions Presented.

Two questions are presented for consideration, namely:

1. Whether the sum of $125,000.00 received by petitioner, Frank White in compromise and settlement of his suit for title to certain land which he claimed by virtue of a gift of the same to him, was income to petitioners within the meaning of the term "income" in the Sixteenth Amendment to the Constitution of the United States, as defined by this Court in *Eisner* v. *Macomber,* 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521.

2. Whether, if such amount be considered income within the meaning of the Sixteenth Amendment, the same was exempt from petitioners gross income as being "the value of property acquired by gift," under Section 22 (b) (3) of the Revenue Act of 1932 (47 Stat. at L. 169, Chap. 209).

IV.

Reasons Relied On for the Allowance of the Writ.

1. The United States Circuit Court of Appeals for the Fifth Circuit, has rendered a decision in conflict with the decision of the Circuit Court of Appeals for the Fourth Circuit in *Magruder* v. *Segebade,* 94 F. (2) 177, which held that an amount received in compromise and settlement of a claim to a portion of a deceased's estate was not taxable income because the same was not a "gain derived from capital, from labor, or from both combined", within the meaning of the term *Income* in the Sixteenth Amendment to the Constitution, as defined by this Court in *Eisner* v. *Macomber.*

2. The Circuit Court of Appeals for the Fifth Circuit in the instant case has rendered a decision in conflict with the decision of the Circuit Court of Appeals for the Third Circuit in *Central Railroad Co.* v. *Comm.,* 79 F. (2) 697, and in conflict with the decision of the Circuit Court of Appeals for the Sixth Circuit in *Farmer's & Merchants' Bank of Catlettsburg* v. *Comm.,* 59 F. (2) 912, which held (1) that the taxable or non-taxable character of an amount received in compromise and settlement of litigation must be determined in the light of the claim from which it was realized; (2) that if the thing claimed would not be taxable income when received, a sum of money accepted in lieu thereof would likewise not be taxable when received.

3. The Circuit Court of Appeals for the Fifth Circuit has decided a Federal question in a way probably in conflict with

an applicable decision of this Court, to wit: *Lyeth* v. *Hoey*, 305 U. S. 188, 59 S. Ct. 155, 83 L. Ed. 119, which held (1) that an amount received by an heir in settlement of a will contest was not subject to income tax, for the reason that such amount was exempt under Section 22 (b) (3) of the Revenue Act of 1932 as "property acquired by * * * inheritance"; (2) the fact that the property was acquired by a compromise agreement rather than through a judgment of the court did not change its character so as to make it subject to income tax; (3) The doctrine that the claimant "realized on a bargaining position" and sold his right to contest for the amount received by him in settlement is disapproved by the Court.

Wherefore, your petitioners pray that a writ of certiorari issue under the seal of this Court, directed to the Circuit Court of Appeals for the Fifth Circuit, commanding said court to certify and send to this Court a full and complete transcript of the record and of the proceedings of the said Circuit Court of Appeals had in the case numbered and entitled on its docket, No. 9624, styled Frank White, et al., Appellants, versus W. A. Thomas, Collector of Internal Revenue, Appellee, to the end that this cause may be reviewed and determined by this Court as provided for by the statutes of the United States; and that the judgment herein of said Circuit Court of Appeals for the Fifth Circuit be reversed by the Court, and for such further relief as to this Court may seem proper.

Dated April 10, 1941.

WM. A. BLAKLEY,
Counsel for Petitioners.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 947

FRANK WHITE, ET UX, MRS. FRANK WHITE,
Petitioners and Appellants Below,

vs.

W. A. THOMAS, COLLECTOR OF INTERNAL REVENUE.
Respondent and Appellee Below.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

I.

Opinions of Courts Below.

The opinion in the District Court of the United States for the Northern District of Texas, Dallas Division, appears in the Record herein at page 127. It has not been officially reported. It was written by Hon. William H. Atwell, District Judge.

The opinion in the United States Circuit Court of Appeals for the Fifth Circuit appears in the Record herein at page 138. It is officially reported in 116 F. (2) 147. It was written by Hon. Samuel H. Sibley, Circuit Judge.

II.

Jurisdiction.

The basis for jurisdiction is set forth at page 4 of the foregoing petition.

III.

Statement of the Case.

This has already been stated in the preceding petition under Paragraph I, at page 1, which is hereby adopted and made a part of this brief.

IV.

Specification of Errors.

1. Both courts below erred in holding that the $125,000.00 received by Frank White was income to him within the meaning of the Sixteenth Amendment to the Constitution of the United States.

2. The District Court erred in holding that the $125,000.00 received by Frank White was not "the value of property acquired by gift" within the meaning of Section 22 (b) (3) of the Revenue Act of 1932.

3. The Circuit Court of Appeals erred in holding that the $125,000.00 received by Frank White was a "gain from the conversion of a gift", and hence taxable as income.

V.

Constitution, Statutes and Commissioner's Regulations Involved.

The Sixteenth Amendment to the Constitution of the United States. The Congress shall have power to lay and

collect taxes on incomes from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

THE REVENUE ACT OF 1932.

The Revenue Act of 1932, *Section* 22 (26 *U. S. C. A., Sec.* 22 (*a*)), *Gross Income.* (a) General Definition.—"Gross income" includes gains, profits and income derived from salaries, wages, or compensation for personal services, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this title:

* * * * * * *

(3) *Gifts, Bequests and Devises.—The value of property acquired by gift, bequest, devise or inheritance* (but the income from such property shall be included in gross income).

Commissioners Regulations 77.

Commissioners Regulation 77 *to the Revenue Act of* 1932. *Article* 51—*What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, un-

less exempt from tax by law. *In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets.* • • •

Article 81.—*Exclusions from Gross Income.*—The term "gross income" as used in the Act does not include those items of income exempt by statute or by fundamental law.

Article 83.—*Gifts and Bequests.*—Property received as a gift, or received under a will or under statutes of descent and distribution is exempt from the income tax, although the income therefrom derived from investment, sale, or otherwise is not. • • •

VI.

ARGUMENT.

Summary of Argument.

First Point. A conflict exists between several the Circuit Courts of Appeals on the question as to whether amounts received in compromise and settlement of claims of a non-taxable character are income subject to income tax.

(1) The United States Circuit Courts of Appeals for the Third, Fourth, and Sixth Circuits have held such amounts do not constitute income, because they are not gains derived from capital, from labor, or from both combined.

(2) The United States Circuit Court of Appeals for the Second Circuit, and the United States Circuit Court of Appeals for the Fifth Circuit (in the instant case) have held such amounts to be taxable income, on the theory that the claimant has "sold" or "converted" his claim,

which has no cost basis, into money or property, and thereby has "realized" income.

Argument on First Point.

(1)

In *Eisner* v. *Macomber,* 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, this Court held that in order to be "income"; within the meaning of the Sixteenth Amendment, an amount must be a gain derived from capital, from labor, or from both combined, including a gain derived from the sale or conversion of a capital asset, and that Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution. This definition has been adopted by the Commissioner of Internal Revenue in his Regulations. (See Commissioners Regulations 77 to the Revenue Act of 1932, quoted herein at Page 9.)

The United States Circuit Court of Appeals for the Third Circuit, in *Central Railroad Co.* v. *Commissioner of Internal Revenue,* 79 F. (2d) 697, held that an amount received in compromise and settlement of a suit for damages for fraudulent conspiracy was not income to the taxpayer, because the property received by him could not be traced to either capital or labor.

The United States Circuit Court of Appeals for the Sixth Circuit, in *Farmers & Merchants Bank* v. *Commissioner of Internal Revenue,* 59 F. (2d) 913, held that money received in compromise and satisfaction of a suit for damage and loss of business occasioned by malicious conduct on the part of the defendant, was not income to the taxpayer, because, considered in the light of the claim from which it was realized, there was no "gain", but only recompense for an injury.

The United States Circuit Court of Appeals for the Fourth Circuit, in *Magruder* v. *Segebade,* 94 F. (2d) 177,

held that money received by the taxpayer in consideration that he give up his claim to portions of a deceased's estate was not subject to income tax, because there was no gain derived from either capital or labor or from a sale or conversion of capital assets. This case is considered particularly important by petitioner because the conflict between it and the case of *Lyeth* v. *Hoey*, 96 F. (2d) 141, by the Circuit Court of Appeals for the Second Circuit, moved this Court to grant certiorari in *Lyeth* v. *Hoey*, resulting in the reversal of the *Lyeth* case. (See 305 U. S. 188, 59 S. Ct. 155.) The holding in *Lyeth* v. *Hoey* is discussed below.

(2)

The United States Circuit Court of Appeals for the Second Circuit has twice held that an amount received in compromise of a claim was income, on the theory that the claimant "sold" his claim and realized a taxable profit. In *Sterling* v. *Commissioner of Internal Revenue*, 93 F. (2d) 304, the court held that an amount received by a taxpayer in settlement of her claim to an interest in realty belonging to the estate of her deceased father was taxable in full, upon the theory, as stated in the court's opinion (at page 306) that "her claim to an interest in the premises would seem to have been a capital asset, the sale of which for a sum greater than it was worth on March 31, 1913, involved a taxable gain." Certiorari was denied by the Supreme Court. (303 U. S. 663, 82 L. Ed. 1121, 58 S. Ct. 829.)

Again, in *Monroe L. Lyeth* v. *Hoey, Collector*, 96 F. (2d) 141, the same court held that an amount received by an heir in compromise of litigation over a will was taxable in full, upon the ground that the taxpayer had certain rights in the deceased's estate, such rights costing him nothing, which he relinquished in return for the amount agreed upon, thus realizing a profit out of a "bargaining position". From the holding in this case, this court granted certiorari be-

cause of the conflict with the holding of the Fourth Circuit Court in *Magruder* v. *Segebade,* 94 F. (2d) 177, above mentioned. This court then reversed the Circuit Court for the Second Circuit, near the close of its opinion expressly disapproving the fallacious "bargaining position" theory, and affirmed the summary judgment of the District Court (20 F. Supp. 619) which had held the receipts not to be income because they were not a gain derived from capital, labor, or both combined.

Second Point. The United States Circuit Court of Appeals for the Fifth Circuit in the instant case has decided a Federal question in probable conflict with an applicable decision of this court.

(1) The decision of the Circuit Court of Appeals in the instant case is in probable conflict with an applicable decision of this Court, namely: *Lyeth* v. *Hoey,* 305 U. S. 188, 59 S. Ct. 155, 83 L. Ed. 119, 119 A. L. R. 410.

Argument on Second Point.

In *Lyeth* v. *Hoey* this Court held that property received by an heir in compromise and settlement of his claims in a will contest was acquired by inheritance, hence was exempt from income tax under the provisions of Section 22 (b) (3) of the Revenue Act of 1932 (47 Stat. at L. 178, chap. 209) which excludes from gross income "the value of property acquired by gift, bequest, devise or *inheritance.*" In reaching this conclusion this Court held:

(a) If the taxpayer's contest of the will had been fought to a successful finish, or if he had sued as heir for a portion of the estate and had recovered a judgment for such portion, what he received would have been acquired by inheritance, hence not taxable.

(b) The fact that the property was received under a compromise agreement in lieu of such a judgment did not change the character of what was received so as to render it taxable.

(c) The court expressly disapproved the theory upon which the court below found the receipt to be taxable income; namely, that taxpayer realized on a "bargaining position".

Notwithstanding this Court's expressed disapproval of the theory that one who received a consideration in compromise of a non-taxable claim realizes on a "bargaining position" taxable income, the United States Circuit Court of Appeals has decided the instant case upon this theory. We take the liberty of quoting that portion of the lower court's opinion so holding. (Found herein at R. page 140.)

"They (the executors and trustees of the Shannon Estate) paid him money for the release of the right which he claimed in the land. White sold that right, and conveyed it by suffering the adverse judgments. He converted it into cash; and the gain from the conversion of a gift is taxable, though the receipt of the gift originally was not. * * * He sold only his claim to recover it, which was in the nature of an incumbrance on the title, at a price which was only a fraction of the value of the land; and that claim he does not say cost him anything. What he received is income."

Respondent has heretofore contended that *Lyeth* v. *Hoey* was not applicable as an authority in the instant case, Frank White being no heir, and the litigation compromised not a will contest. But the Revenue Act of 1932 exempts both acquisitions by *inheritance* and acquisitions by *gift*. It applies to one claiming as a *donee* as well as to one claiming as an heir. The same principles of law, as enunciated by this Court, apply to both cases. Thus, had Frank White recovered the property claimed by him in his suit, it cannot

be doubted that such property would have stood as a gift. Does the fact that he accepted the amount involved in lieu of such property change its character for tax purposes? The slight difference in the facts of the two cases in no way affects the identical principles of law involved in both cases. The conflict arises, not out of the facts involved, but out of the application by the court below of an incorrect theory of law heretofore disapproved by this Court.

Conclusion.

From a consideration of the foregoing matters, it appears, first, that the decision in the instant case is in conflict with the decisions of other Circuit Courts of Appeal, which conflict should be resolved by the United States Supreme Court; second, that in the instant case a Federal question has been decided in conflict with an applicable decision of the Supreme Court;

WHEREFORE, petitioners respectfully submit that the writ of certiorari prayed for should be granted.

WM. A. BLAKLEY,
Attorney for Petitioners.

(3773)

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Lyeth v. *Hoey*, 305 U. S. 188 — 5

Magruder v. *Segebade*, 94 F. (2d) 177 — 4

Sterling v. *Commissioner*, 93 F. (2d) 304, certiorari denied, 303 U. S. 663 — 4

Statute:

Revenue Act of 1932, c. 209, 47 Stat. 169:

Sec. 22 — 2

316417—41

In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 947

FRANK WHITE ET UX, MRS. FRANK WHITE,
PETITIONERS

v.

W. A. THOMAS, COLLECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 127–130) is not reported. The opinion of the Circuit Court of Appeals (R. 138–140) is reported in 116 F. (2d) 147.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 5, 1940. (R. 141.) A petition for rehearing was denied on January 14, 1941. (R. 149.) The petition for a writ of certiorari was filed April 12, 1941. The jurisdiction

of this Court is invoked pursuant to the provisions of Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The petitioner received $125,000 during the taxable year in settlement of an action brought by him to recover real property.

The question is whether this payment constituted taxable income.

STATUTE INVOLVED

Revenue Act of 1932, c. 209, 47 Stat. 169:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after the date of the enactment of this Act, the compensation received as such shall be included in gross income; and all Acts fixing the compensation of such Presidents

and judges are hereby amended accordingly.

(b) *Exclusions From Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this title:

* * * * *

(3) *Gifts, Bequests, and Devises.*—The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income);

* * * * *

STATEMENT

Frank White was an employee and protege of Mrs. Margaret A. Shannon prior to her death on December 13, 1931. (R. 20, 108–109.) In her will, Mrs. Shannon left certain real estate and some stock to White. (R. 24.) However, he claimed that Mr. and Mrs. Shannon had, during their lifetime, given him a ranch in Crockett County, Texas. (R. 110.) He sued the executors of Mrs. Shannon's estate during 1932, to try the title to the ranch. (R. 20.) The executors filed another suit to clear the title. (R. 21.) During March, 1932, White and the executors entered into a compromise and settlement of the respective claims and counter claims, under which White was to receive $125,000 in addition to the property specifically bequeathed to him by will. (R. 21.)

The petitioners filed income tax returns for the year 1932, without including any part of the $125,000 received from the executors. The Commissioner of Internal Revenue ruled that the whole sum should have been included, and asserted deficiencies accordingly. The petitioners paid the additional taxes, and then filed claims for refund, which were duly rejected. (R. 22.) The petitioners then sued the Collector in the District Court, which held that the sum received in settlement was taxable income, and gave judgment for the Collector. (R. 129.)

ARGUMENT

1. The decision below is in full accord with the decision of the Circuit Court of Appeals for the Second Circuit in *Sterling* v. *Commissioner,* 93 F. (2d) 304, a case involving facts which are substantially the same as those here presented. This Court denied certiorari in the *Sterling* case (303 U. S. 663), despite the assertion of conflict with *Magruder* v. *Segebade,* 94 F. (2d) 177 (C. C. A. 4th), *Central R. Co.* v. *Commissioner,* 79 F. (2d) 697 (C. C. A. 3d), and *Farmers' & Merchants' Bank* v. *Commissioner,* 59 F. (2d) 912 (C. C. A. 6th), the very decisions upon which the petitioner in this case bases his allegation of conflict. There would seem to be no more persuasive reason for the grant of the writ in this case than there was in the *Sterling* case.

2. The decision in *Lyeth* v. *Hoey*, 305 U. S. 188, is distinguishable. There the taxpayer had received property from the estate of a decedent in compromise of his claim as an heir. This Court held that the taxpayer acquired the property by "bequest, devise, or inheritance" and he was therefore exempt from income tax. Here, on the other hand, there is no assertion that the property forming the subject of the litigation was left by will or that the taxpayer could claim it as an heir. Moreover, it cannot reasonably be held that the $125,000 compromise payment was exempt from income tax as property "acquired by gift". There is no claim that Mrs. Shannon made the taxpayer a gift of $125,000 and her executors were without power to make such a gift. It would seem, therefore, that the rationale of *Lyeth* v. *Hoey* is inapplicable to the situation here presented.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

FRANCIS BIDDLE,
Solicitor General.
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MAY, 1941.

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